Supreme Court, U. S.
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80-1188
No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

JAMES EDGAR,

Appellant,

vs.

MITE CORPORATION and MITE HOLDINGS, INC.,

Appellees.

ON APPEAL FROM THE UNITED STATES
COURT OF APPEALS FOR THE SEVENTH CIRCUIT

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

Whether the Illinois Business Take-Over Act conflicts with the Williams Act amendments to the Securities Exchange Act of 1934?

Whether the Illinois Business Take-Over Act regulates evenhandedly to effectuate strong legitimate local interests that outweigh the incidental effect on interstate commerce, and is valid under the commerce clause?

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the United States District Court for the Northern District of Illinois, Eastern Division, has not been reported, but is included in the appendix at p. 32a. The opinion of the United States Court of Appeals for the Seventh Circuit is not reported, but is included in the appendix at p. 1a.

JURISDICTION

Appellees initiated this action in the United States District Court for the Northern District of Illinois, Eastern Division, pursuant to Section 27 of the Securities and Exchange Act of

1934 (15 U.S.C. § 78aa), 28 U.S.C. §§ 1332, 1337 and 42 U.S.C. 1983, and the district court held that the Illinois Business Take-Over Act (Ill. Rev. Stat. 1979, ch. 121½, § 137.51 *et. seq.)* was unconstitutional.

The judgment of the United States Court of Appeals for the Seventh Circuit, affirming the district court, was entered on October 17, 1980. See p. 42a. A notice of appeal to this Court was duly filed on January 5, 1981, in the United States Court of Appeals for the Seventh Circuit. See p. 43a.

This appeal is being docketed in this Court within 90 days of entry of the order below. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article 1, section 8 of the United States Constitution provides in pertinent part that:

> The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

Article VI of the United States Constitution provides in pertinent part that:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every state shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Illinois Business Take-Over Act, Ill.Rev.Stat. 1979, ch. 121½, § 137.51 *et seq.*

(See Appendix, p. 45a)

Williams Act amendments to the Securities Exchange Act of 1934 (15 U.S.C. § 78m(d)-(e), 78 n(d)-(f)(1976). The pertinent sections are set forth in the Appendix at 65a.

STATEMENT OF THE CASE

Appellant, James Edgar, is the Secretary of State of Illinois and is charged with the administration and enforcement of the Illinois Business Take-Over Act (Ill. Rev. Stat. 1979, ch. 121½, § 137.51 *et. seq.*) (the "Illinois Act"). MITE Corporation and MITE Holdings, Inc., (collectively "MITE") sought to make a cash tender offer for the shares of Chicago Rivet and Machine Co. ("Chicago Rivet") without having to comply with the Illinois Act. Chicago Rivet is a publicly-held Illinois Corporation with its principal executive offices in Bellwood, Illinois. Chicago Rivet has 866,264 shares of common stock outstanding and 2,181 shareholders of record. Of those shareholders, 589 are residents of Illinois, and they own 377,395 common shares.

On January 19, 1979, MITE filed a Schedule 14D-1 with the Securities and Exchange Commission (the "SEC") concerning its proposed tender offer, pursuant to section 14(d)(1) of the Williams Act, 15 U.S.C. § 78n(d)(1) (1976), and Regulation 14D promulgated thereunder. MITE's proposed tender offer of $28.00 per share for all the shares of Chicago Rivet represented a premium of more than $4.00 per share over the market price preceding announcement of the offer.

MITE initiated this action on January 19, 1979, seeking to have the district court declare the Illinois Act null and void on its face because it violated the supremacy and commerce clauses of the United States Constitution. In addition MITE sought injunctive relief prohibiting then Secretary of State Alan J. Dixon and Chicago Rivet from enforcing the Illinois Act against it in connection with its proposed tender offer.

On January 22, 1979, Chicago Rivet filed an action in the Court of Common Pleas of Blair County, Pennsylvania, alleging that MITE was in violation of the Pennsylvania Take-Over Disclosure Law, 70 Pa. Cons. Stat. Ann. tit. 70, § 71 *et seq.* (Purdon Supp. 1978). The court issued an *ex parte* order enjoining MITE from pursuing its tender offer pending further

hearing on January 26, 1979. On January 22, 1979, Chicago Rivet also filed a complaint with the Pennsylvania Securities Commission. MITE removed the action filed in the Court of Common Pleas of Blair County to the United States District Court for the Western District of Pennsylvania, and also filed a complaint seeking to have the Pennsylvania Act declared unconstitutional and to have its enforcement enjoined. On January 31, 1979, the Pennsylvania Securities Commission determined that it would not invoke the Pennsylvania Act, and on the next day the District Court for the Western District of Pennsylvania denied Chicago Rivet's motion for a temporary restraining order.

On February 1, 1979, Dixon executed a temporary cease and desist order and notice of hearing regarding the proposed tender offer and notified MITE that the order and notice would be served February 5, 1979. On February 2, 1979, the district court entered an order preliminarily enjoining Dixon from enforcing the Illinois Act against MITE in connection with its tender offer for the shares of Chicago Rivet. MITE published its tender offer to all shareholders of Chicago Rivet in the national edition of the *Wall Street Journal* on February 5.

The district court entered its final judgment order on February 9, 1979, declaring the Illinois Act to be null and void. The district court held that the Illinois Act was preempted by the Williams Act and created an undue burden on interstate commerce in violation of the commerce clause. The district court also permanently enjoined Dixon from enforcing the Illinois Act against MITE in connection with its tender offer for the shares of Chicago Rivet.

Appellant appealed to the Court of Appeals for the Seventh Circuit from the final judgment order of the district court declaring the Illinois Act to be null and void. The Court of Appeals for the Seventh Circuit affirmed, holding that the Illinois Act was preempted by the Williams Act and also constituted an undue burden on interstate commerce in violation of the commerce clause.

THE QUESTIONS ARE SUBSTANTIAL

I.

THE ILLINOIS BUSINESS TAKE-OVER ACT IS NOT INFIRM UNDER THE SUPREMACY CLAUSE BECAUSE STATE REGULATION THAT PROVIDES ADDITIONAL PROTECTION FOR THE SHAREHOLDER CONFRONTED WITH A TENDER OFFER DOES NOT CONFLICT WITH THE WILLIAMS ACT.

The question of whether the Illinois Act conflicts with the Williams Act amendments to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f)(1976), or is invalid under the commerce clause of the United States Constitution is a substantial one as the great majority of states have enacted analogous statutes regulating tender offers.[1] The validity of state regulation of tender offers under the Williams Act and commerce clause has not been treated before by this Court.[2]

This Court has said that the sole purpose of the Williams Act was to protect investors confronted with a tender offer. *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 35, 51 L.Ed.2d 124 (1977). The Williams Act is the product of the increasing use of the cash tender offer during the 1960's as a virtually unregulated method of corporate acquisition. *Id.* at 22. When Congress enacted the Williams Act the first state takeover statute had already been enacted (Va. Code §§ 13.1-528 *et seq.* (1978), effective March 5, 1968). It is significant that despite the proliferation of state takeover statutes the use of the tender offer mechanism for corporate acquisition has not been de-

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[1] See, Note, *Securities Law and the Constitution: State Tender Offer Statutes Reconsidered*, 88 Yale L.J. 510, 514-515, n 29(1979) (hereinafter *"Tender Offer Statutes Reconsidered"*), which lists the analogous statutes enacted in 36 States.

[2] In *Leroy* v. *Great Western United Corporation*, 443 U.S. 173, 61 L.Ed. 2d 464(1979), this Court reversed on grounds of improper venue and did not pass on the validity of the Idaho statute.

terred. *AMCA International Corp.* v. *Krouse,* 482 F.Supp. 929, 938 (S.D. Ohio, 1979); *Tender Offer Statutes Reconsidered, supra,* n.1, at 523.

The Seventh Circuit Court of Appeals did not hold that Congress has expressly barred the states from regulating tender offers. This Court has said that § 28(a) of the Securities Exchange Act of 1934[3] "was plainly intended to protect, rather than to limit, state authority." *Leroy* v. *Great Western United Corp.,* 443 U.S. 173, 182, 61 L.Ed. 2d 464 (1979). The Williams Act does not contain language expressing direct preemptive intent, and on the occasions that Congress has amended the Williams Act it has not expressly preempted concurrent state regulation. *AMCA, supra,* 482 F.Supp. at 935. Nor did the Seventh Circuit Court of Appeals hold that the federal scheme of regulating tender offers is sufficiently pervasive to infer an implicit congressional intent to preempt state legislation. It is also clear that the field of securities regulation is not an area of paramount federal importance, such as national security or foreign affairs, in which federal legislation that is not pervasive will nevertheless preempt state legislation. *See Pennsylvania* v. *Nelson,* 350 U.S. 497,504-505, 100 L.Ed. 640(1956); *Hines* v. *Davidowitz,* 312 U.S. 52,67, 85 L.Ed. 581(1941). The coexistence of federal and state regulation of securities transactions is established. *Merrill Lynch, Pierce, Fenner & Smith* v. *Ware,* 414 U.S. 117, 127, 38 L.Ed.2d 348(1973).

Absent explicit or implicit preemption, the validity of the Illinois Act depends upon whether it "stands as an obstacle to the accomplishment and execution of the full purposes and

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[3] Section 28(a), as set forth in 15 U.S.C. § 78bb(a)(1976), provides in pertinent part:

> Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

objectives of Congress." *Hines* v. *Davidowitz*, 312 U.S. 52,67,85 L.Ed. 581(1941). The Seventh Circuit Court of Appeals concluded that the Williams Act protects investors by a "market approach" and is also designed to preserve a neutral balance between incumbent management and offeror. See *Great Western United Corp.* v. *Kidwell*, 577 F.2d 1256(5th Cir. 1978), *rev'd on venue grounds sub nom. Leroy* v. *Great Western United Corp.*, 443 U.S. 173, 61 L.Ed.2d 464(1979). This Court has said that "Congress was indeed committed to a policy of neutrality in contests for control, but its policy of evenhandedness does not go . . . to the purpose of the legislation . . ." which was to protect investors. *Piper, supra*, 430 U.S. at 29. As the Illinois Act provides the investor confronted with a tender offer with additional protection, supplementing that provided by the Williams Act, the fact that the balance between the respective positions of incumbent management and offeror might be affected, or that a particular offeror might not prevail in a particular tender offer does not thwart the purpose of Congress in enacting the Williams Act.

Apart from the disclosure requirements in sections 13(d) and 14(d) of the Williams Act, investors are afforded certain substantive protections. 15 U.S.C. §§ 78m(d), 78n(d). Tendering shareholders can withdraw stock within the first seven days of an offer or any time after sixty days. 15 U.S.C. § 78n(d)(5)(1976).[4] When a tender offer is for less than all of the outstanding shares, those shares tendered during the first ten days must be taken up pro rata by the offeror. 15 U.S.C. § 78n(d)(6)(1976). Finally, if the amount of consideration is later increased all tendering shareholders will receive the higher price. 15 U.S.C. § 78n(d)(7)(1976). The Seventh Circuit

[4] The SEC has extended the seven day withdrawal period contained in the Williams Act to fifteen business days. 17 C.F.R. § 240.14d-7 (1979).

Court of Appeals held that the following provisions of the Illinois Act would unduly aid incumbent management and would deter the making of tender offers to the detriment of the investor. The Illinois Act requires that an offeror file a registration statement with the Secretary of State, and that the offer will automatically become registered after 20 business days, unless the Secretary accelerates or delays the period or calls a hearing (Ill.Rev.Stat.1979, ch. 121½, § 137.54.C.,E.).[5] The Illinois Act provides for a hearing if the Secretary deems it necessary for the protection of Illinois offerees, or if one is requested by a majority of the outside directors or by Illinois residents who hold at least 10% of the shares (Ill.Rev.Stat.1979, ch. 121½, § 137.57.A.). The hearing is to commence within ten days, unless extended by the Secretary for the protection of Illinois offerees or the convenience of the parties, and the Secretary is to issue a decision within fifteen days of the hearing unless the protection of Illinois offerees requires an extension (Ill.Rev.Stat.1979, ch. 121½, § 137.57.C.,E.).

Although a tender offer will proceed at a slower pace under the Illinois Act, this does not conflict with the congressional purpose of protecting the investor, even though it may affect the respective positions of incumbent management and offeror. The element of surprise is eliminated by the pre-effective filing requirement. The element of surprise is unquestionably beneficial to the offeror. If the target company is successful in finding another bidder, the original offeror is detrimentally affected, but the Williams Act was not enacted to protect the offeror.

The closer scrutiny of an offer under the Illinois Act and the provision for a hearing before the Secretary of State necessitate some delay, but this is necessary to protect the

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[5] The 20 day pre-offer filing required under the Illinois Act conflicts directly with the SEC's new Rule 14-d-2. 17 C.F.R. § 240.14d-2b. The Seventh Circuit Court of Appeals did not rely on the new SEC rules because those rules do not apply to tender offers made prior to their effective date. 44 Fed. Reg. 70326 (1979). Cf. *AMCA, supra*, 482 F. Supp. at 933-34, n.4.

shareholder and does not unduly inhibit the making of tender offers. Although the respective ten and fifteen day periods for holding a hearing and issuing a determination can be extended by the Secretary if necessary, they certainly constitute a guideline within which the Secretary would act in an ordinary case. Of course during the whole period the activities of incumbent management are also covered by the Illinois Act (Ill.Rev.Stat. 1979, ch. 121½, §§ 137.55., 137.58.(1)-(3), 137.62.B., 137.63.A.,B.). As noted earlier the use of the tender offer as the preferred method for corporate acquisition has not diminished during the proliferation of state takeover legislation. The opponents of the Williams Act predicted it would have a crippling effect upon offerors, but it has been suggested that the Williams Act had no impact on the relative strength of management and the offeror.[6]

The protection afforded investors from review by the Secretary of State is consistent with the purpose of the Williams Act, and any shift in the respective positions of incumbent management and offeror is immaterial when the longer duration is not inimical to the interests of the shareholder. The type of review by the Secretary of State under the Illinois Act cannot be deemed a deviation from a market approach. The Seventh Circuit Court of Appeals, however, said that the Illinois Act replaced the autonomy of the investor with a "benevolent bureaucracy" because section 137.57.E. provides in pertinent part that:

> If the Secretary finds that the take-over offer fails to provide full and fair disclosure to the offerees of all material information concerning the take-over offer, *or that the take-over offer is inequitable or would work or tend to work a fraud or deceit upon the offerees,* . . . the Secretary shall by order deny the registration of the take-over offer or condition its registration upon certain changes or modifications . . . (emphasis added) Ill.Rev.Stat.1979, ch. 121½, § 137.57.E.

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[6] Shipman, *Some Thoughts About The Role Of State Takeover Legislation: The Ohio Takeover Act,* 21 Case Western L. Rev. 722, 760-61(1970).

The Seventh Circuit Court of Appeals said that inclusion of "or that the take-over offer is inequitable" empowers the Secretary to pass on the substantive fairness of the offer. The foregoing section does not empower the Secretary of State to judge the substantive fairness of the amount of the premium over the market price, which remains the unfettered decision of the investor. The word "inequitable" is coupled with "fraud" and "deceit" and simply does not put the Secretary in the position of looking at the amount of the offer. Review by the Secretary of whether there has been full disclosure, or whether the offer would be inequitable or work a fraud or deceit protects the shareholder who, in the absence of incomplete or misleading disclosure or fraud, will decide whether to tender his shares. Protecting the shareholder against fraud is not inconsistent with the Williams Act, which contains anti-fraud provisions. 15 U.S.C. §§ 78m(e), 78n(e)(1976).

II.

STATE TAKEOVER LEGISLATION WHICH REGULATES EVENHANDEDLY TO EFFECTUATE LEGITIMATE LOCAL INTERESTS, THAT OUTWEIGH THE INCIDENTAL EFFECT ON INTERSTATE COMMERCE, DOES NOT CONTRAVENE THE COMMERCE CLAUSE.

State legislation serving legitimate local interests that does not discriminate against interstate commerce is valid under the commerce clause even though it affects commerce. *Raymond Motor Transportation, Inc.* v. *Rice,* 434 U.S. 429, 440, 54 L.Ed.2d 664(1978). In *Raymond* this Court quoted the established rule that:

> '[I]n areas where activities of legitimate local concern overlap with the national interests expressed by the Commerce Clause—where local and national powers are concurrent—the Court in the absence of congressional guidance is called upon to make "delicate adjustment of the conflicting state and federal claims." ' (citations omitted) *Id.* at 440.

The test used in making the "delicate adjustment" is contained in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142, 25 L.Ed.2d 174(1970), in which this Court said that:

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. *Huron Cement Co.* v. *Detroit*, 362 U.S. 440, 443. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

In its decision, the Seventh Circuit Court of Appeals said that Illinois' interest in protecting resident shareholders and regulating control transfers are tenuous and cannot justify the Illinois Act's effect on interstate commerce. Chicago Rivet is an Illinois corporation with its principal executive office in Illinois. Over 43% of Chicago Rivet's common stock is held by the 27% of its shareholders who are residents of Illinois. The Seventh Circuit Court of Appeals said that the Illinois Act would have applied even if no shareholder of Chicago Rivet resided in Illinois. A "target company" under the Illinois Act is one in which 10% of the shares are held by securityholders located in Illinois, or that meets two of the following conditions: (a) has its principal executive office in [Illinois]; (b) is organized under the laws of [Illinois]; (c) has at least 10% of its stated capital and paid-in surplus represented in [Illinois] (Ill.Rev.Stat. 1979, ch. 121½, § 137.52-10). If no shareholders resided in Illinois, however, the Secretary could exempt the offer from registration as not necessary for the protection of Illinois securityholders (Ill.Rev.Stat.1979, ch. 121½, § 137.52-9(5)). Protecting investors residing in a state has long been recognized as a legitimate state objective. *Hall* v. *Geiger-Jones Co.*, 242 U.S. 539,551, 61 L.Ed. 480(1917); *AMCA, supra*, 482 F. Supp. at 939.

Illinois has a second legitimate local interest in regulating the internal affairs transactions of Illinois or Illinois based corporations with substantial contacts in the State. Illinois can regulate the internal affairs of an Illinois corporation in matters such as a merger or other fundamental corporate changes, shareholder liability and election of directors. See Shipman, *Some Thoughts About the Role of State Takeover Legislation: The Ohio Takeover Act,* 21 Case Western Reserve L.Rev. 722, 742-5 (1970). A tender offer is sufficiently analogous to traditional internal affairs transactions of a corporation which are the subject of state regulation. A successful tender offer means a shift in control in which the initial step is a change in the directors or their policies. A tender offer is like a de facto proxy solicitation because the securityholder who retains some of his shares is also "electing future directors and determining future board policy to govern the remainder of his securities." Shipman, *supra,* at 744. Congress recognized that tender offers are functionally equivalent to proxy fights. H.R. Rep. No. 1711, 90th Cong. 2d Sess (1968). A securityholder who retains his shares in effect receives new shares with a reduction in his voting power. A tender offer does not, however, result in a change in the formal corporate structure, and there is an absence of action contractually binding all shareholders at the corporate level such as in a merger. But a successful offeror will acquire a fiduciary relationship to the corporation and its securityholders. The offeror will obtain control through the securityholders acting in unison via the mechanism of the tender offer. The cumulative effect of a tender offer so closely resembles a proxy solicitation that Illinois can regulate a tender offer as an internal affair of an Illinois or Illinois based corporation. Shipman, *supra,* at 745.

In its decision the Seventh Circuit Court of Appeals said that had the Secretary of State not been enjoined over 23 million dollars of interstate commerce would have been affected. The burden of compliance with the Illinois Act, however, is

not such that would prevent the free flow of interstate commerce. Although the possibility exists that in a particular case more than one state would invoke jurisdiction, the Illinois Act contains a comity provision, which provides that when the Secretary determines that another jurisdiction is applying a statute which affords substantially equal protection, the registration and filing requirements of the Illinois Act will not apply (Ill.Rev.Stat.1979, ch. 121½, 137.53.). The unavoidable extraterritorial effect of the Illinois Act is also tempered by the fact that the vast majority of states also have takeover statutes. The requirements of the Illinois Act do not impose a substantial burden on interstate commerce because they are hardly of a magnitude to dissuade a company from proceeding with such a major business decision as that of acquiring another company.

CONCLUSION

For these reasons, this Court should note probable jurisdiction of this appeal.

Respectfully submitted,

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